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AUG 2 2 1996

Federal Communications Commission
Office of Secretary

Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)	
	)	
	)	CC Docket No. 92-297
Rulemaking to Amend Parts 1, 2, 21, and 25	)	
of the Commission's Rules to Redesignate	)	
the 27.5 - 29.5 Ghz Frequency Band, to	)	
Reallocate the 29.5 - 30.0 Ghz Frequency	)	
Band, to Establish Rules and Policies and	)	
Local Multipoint Distribution Service and	)	DOCKET FILE COPY ORIGINAL
for Fixed Satellite Services	)	

REPLY COMMENTS OF THE UNITED STATES DEPARTMENT OF JUSTICE

David Turetsky
Andrew S. Joskow
Deputy Assistant Attorneys General
Antitrust Division

Communications with respect to this documents should be addressed to:

John Hayes
Economist
Economic Regulatory Section

Donald J. Russell
Chief
Telecommunications Task Force

Kate Balaban
Attorney
Telecommunications Task Force

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REPLY COMMENTS OF THE UNITED STATES DEPARTMENT OF JUSTICE

The Federal Communications Commission ("Commission"), in this Fourth Notice of Proposed Rulemaking ("NPRM"), seeks comment on a number of issues relating to its licensing and regulation of local multipoint distribution services ("LMDS"). Among other things, the Commission has asked for comments on whether telephone companies (local exchange carriers or "LECs") and cable companies should be permitted to bid for and acquire LMDS licenses within their current service areas.

The United States Department of Justice ("Department"), as a Federal agency responsible for enforcing the antitrust laws and promoting competition, offers these comments for the Commission's consideration in resolving that issue.

The Department has strongly supported the Commission's allocation of scarce spectrum licenses through the use of auctions. Auctions tend to distribute licenses to those who expect to derive the greatest profits from the use of the auctioned asset. In many contexts, this tendency operates for the benefit of both consumers and producers, because the most profitable use of the asset will be the use that provides the products and services that consumers most desire, in the most efficient manner.[1]

This desirable characteristic of auctions, however, is absent when the winning bidder's private interests diverge from broader social interests. In particular, social and private interests are likely to diverge if the asset to be auctioned can be used to bring increased competition to markets in which a firm is currently earning monopoly profits. In this context, the monopolist would likely place a higher value on the asset, and bid more to acquire it, than would potential competitors to the monopolist; by acquiring the asset, the monopolist can protect its monopoly profits, while other bidders would expect the lesser profits that could be earned in a more competitive market. A monopolist might find it most profitable to use the auctioned spectrum inefficiently, such as, for example, by warehousing the spectrum or otherwise preventing it from being used to directly compete with its monopolized services. Moreover, monopolists will probably find it profitable to

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[1] Paul Milgrom, "Auctions and Bidding: A Primer," *Journal of Economic Perspectives*, pp. 3-22.

acquire the asset in order to preempt the development of competition.[2] Hence monopolists, if they are allowed to bid, can be expected to win spectrum licenses that would otherwise be used to compete against them. In this context, there is a divergence between the socially desirable outcome of the auction, which is a more competitive market, and the outcome that would maximize private profits, which would preserve monopoly power.[3]

Eligibility restrictions, which prevent monopolists from bidding to acquire assets that could be used to compete against the monopolist, protect against this undesirable outcome. The Department has traditionally opposed the acquisition by firms with monopoly power of assets that are likely to be used to compete against such firms. In such cases the harm to competition of such an acquisition is rarely outweighed by any procompetitive efficiencies. This is especially the case where competitive entry is difficult, expensive, time consuming, or limited by government regulatory policies.

As the Commission emphasized in its Notice, LMDS technology is "a potentially important source of competition to both LECs and cable operators."

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[2] See Tracy R. Lewis, "Preemption, Divestiture and Forward Contracting in a Market Dominated by a Single Firm," *American Economic Review*, December 1983, pp. 1091-1101.

[3] See, for example, Richard J. Gilbert and David M.G. Newbery, "Preemptive Patenting and the Persistence of Monopoly," *American Economic Review,* June 1982, pp. 514-26. The comments submitted by Kenneth C. Baseman (on behalf of WebCel) and ComTech Associates (at 11) also address an incumbent's incentives to protect monopoly profits.

(NPRM, ¶ 125) Incumbent LECs and cable companies have extremely high market shares, and exercise substantial market power, in their respective markets. Increased competition in the markets they serve could provide great consumer benefits, and the Commission should adopt auction rules that will facilitate the development of this competition.

A. Telephone Companies Should Be Ineligible To Bid For In-Region LMDS Licenses.

In its Notice, the Commission asks whether it would be in the public interest to restrict the eligibility of incumbent LECs to bid for LMDS licenses within their respective service areas.[4] (NPRM, ¶ 125) The Commission identifies, quite correctly in the Department's view, the central issue in determining whether an eligibility restriction is in the public interest: does the potential for procompetitive use of the licenses by incumbent LECs outweigh the potential for competitive harm from such use? If the answer is no, then a general and proscriptive bar of eligibility would be

[4] The NPRM states explicitly that the Commission's proposed rules contemplate a single LMDS licensee in each service area and the Department's comments are premised on this assumption. (NPRM ¶ 106-107) However, the Department's serious concerns regarding the effect of cross-ownership on the implicated markets would not likely be assuaged even if the Commission were to award two licenses for each BTA. The Commission also questions whether the 300 Mhz located in the 31 Ghz band should be licensed separately from the remaining LMDS spectrum. The Department takes no position on this issue, other than to suggest that if the Commission chooses to license this spectrum separately, it should consider allowing combination bids in the auction.

justified.

Traditionally the Department analyzes cross-ownership issues of this nature using a generic framework borrowed from the Department's 1992 Merger Guidelines. The starting point for such an analysis is to determine whether the auctioned asset, the LMDS spectrum, would likely be used to compete in the relevant market served by the firm whose eligibility is at issue, the in-region LEC. The Commission states that the LMDS spectrum can be used to provide a variety of local telephone services, and the licensees of this spectrum are therefore a likely source of competition in the provision of these services. (NPRM, ¶¶ 100, 106 and 125) This conclusion, in our view, is amply supported by the record in this proceeding. For convenience, we refer to these services as the "local telephone service market."[5]

The next step in the analysis is to measure the degree of concentration in the relevant market, since highly concentrated markets may be susceptible to monopoly pricing and other anticompetitive behavior. There can be little doubt that at the present time, local telephone markets are monopolies controlled by the incumbent

[5]At the present time, we believe it is unnecessary for the Commission, in this context, to define relevant product or geographic markets more precisely; under any of the plausible alternative market definitions, the competitive analysis will be the same, since all of the plausible alternative markets are now characterized by extremely high concentration and incumbents with substantial market power. In the future, however, if competition develops more rapidly in some services or geographic areas than in others, it may be necessary to undertake a more precise geographic and product market definition, to ensure that the Commission's rules and policies adequately account for possible differences among markets.

local exchange carrier. Measured by revenues, the Commission's data show that the BOCs currently provide approximately 99.5 percent of local exchange and exchange access services in their regions.[6]

Next, the Department would examine the potential effect the license acquisition would have on the degree of concentration in the market, as one way of assessing the likely competitive effects of the transaction in question. If the transaction is likely to increase concentration or prevent significant deconcentration in a market that is already highly concentrated, there is a significant risk that it will thereby harm competition.

In the Department's view, the acquisition of LMDS licenses by incumbent LECs would increase the concentration, or prevent significant deconcentration, of ownership of assets that can be used to compete in local telephone markets. Therefore, the potential harm to competition posed by acquisition of LMDS licenses by in-region telephone companies is substantial.

More specifically, incumbent LECs will have substantial economic incentives to use an LMDS license to prevent the development of competition in the local telephone market that it dominates. LECs with monopoly power in the LMDS license area have an incentive to preempt competition to their telephone company

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[6] *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended; and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, CC Docket No. 96-149, ¶ 7, released July 18, 1996.

by purchasing the LMDS license and thereby preventing entry into the local telephone market. Having acquired an LMDS license, an incumbent LEC will have different economic incentives than an LMDS licensee which is unaffiliated with the LEC. An LEC using LMDS spectrum will anticipate the effect of its LMDS service offerings on its local telephone profits and jointly maximize the sum of its local telephone and LMDS profits. Conversely, an unaffiliated LMDS firm would maximize the profits on LMDS service alone. The different incentives faced by affiliated and unaffiliated LMDS firms are likely to lead to different decisions about how to utilize the LMDS spectrum and what prices to charge for the services offered over that spectrum. The incumbent telephone provider's efforts to protect its preexisting monopoly profits would likely lead to inefficient LMDS service provision. The LEC would have incentives to warehouse the spectrum, in whole or in part; to use the spectrum to provide a less-than-optimal mix of services, so as to restrict output in its monopoly market; or to charge higher prices for its services than would a non-LEC LMDS firm.[7] In sum, there is a significant risk of curtailed competition in local telephone markets if LECS are permitted to acquire in-region

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[7]With decreases in the extent of overlap between a LEC's (or a cable company's) service area and the BTA that constitutes the LMDS license area, these anticompetitive incentives diminish. If a LEC's service area constitutes only a de minimis portion of the LMDS license area, the anticompetitive incentives are likely to be minimal. For this reason, the Commission may wish to permit some small degree of overlap.

LMDS licenses.[8]

The Department's analysis also weighs the potential costs of such anticompetitive effects in the local telephone market against potential procompetitive efficiencies resulting from the LEC's use of the licenses. Under this analysis, it would be appropriate to consider whether there might be, for example, procompetitive benefits from the LEC's use of the license to deliver local telephone services more efficiently, or to deliver an entirely new product in a market that has been concentrated in the past. However, since the likely effect of LEC acquisition of the LMDS license is increased concentration in an already concentrated market, LECs have a heavy burden to meet in establishing that such efficiencies really would outweigh the likelihood for harm to the local telephone market. In the Department's view, that burden could be met only if the claimed efficiencies were credible and quantifiable, and if they could be achieved only through the acquisition of the LMDS spectrum, rather than through contractual arrangements.

Moreover, LECs would need to establish that these efficiencies would be available exclusively to them -- that is, that other potential bidders for the license,

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[8]We do not believe that regulation of the use of the spectrum is an appropriate solution to this competitive risk. Use restrictions are difficult to monitor and are an inherently inferior tool for preventing anticompetitive effects in the marketplace. Moreover, were the Commission to impose use restrictions on the winning bidders, then the market itself would be prevented from determining the most efficient use of the licenses. The Commission wisely proposes relatively few restrictions on the use of the LMDS spectrum in order to accommodate a variety of system designs, services and transmission media. (NPRM, ¶ 95)

whose ownership of LMDS spectrum rights would not pose competitive risks, would be incapable of taking advantage of the claimed efficiencies. If there are no economies of scope or other efficiencies that are uniquely available to the LEC, prohibiting the LEC from acquiring the spectrum will not deprive consumers of any benefits; other firms which could achieve the same efficiencies would be likely to acquire the spectrum and take advantage of those efficiencies.

The record in this proceeding contains no significant evidence of efficiencies in the use of LMDS spectrum that would be uniquely available to in-region LECs.[9] The LECs who have commented on this issue suggest that they could use the LMDS spectrum to offer a variety of services, including MVPD services. These commenters, however, offer no evidence that they could use LMDS spectrum for these purposes more efficiently than other firms. Such unique suitability conceivably might be demonstrated if, for example, the LMDS license would enable the LEC to utilize its existing infrastructure to reach its telephone subscribers with a video product. The Commission asked in its Notice for specific evidence relating

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[9] The Commission also requests comment on a closely related issue: whether the LMDS license is the best or a "unique" asset for the LEC to use to enter the video market. (NPRM ¶126) The Department views this question as far less important than whether the in-region LEC, because of its unique position as an in-region service provider with an already existing infrastructure, would be able to use the LMDS license more efficiently than could any other firm. Nevertheless, in answer to the first question, the LECs according to public accounts have a number of strategies and technologies they are considering to enter the video market. At this point, it is doubtful anyone could conclude, including the LECs themselves, that the LMDS asset is unique and essential to them in this regard.

to such potential economies of scope. The commenters have failed to identify any such evidence, and the Department has no independent basis for believing that such economies would exist.

On this record, we believe the Commission should bar in-region LECs from acquiring LMDS spectrum rights. Such acquisitions would pose substantial risks to competition in local telephone markets, and there is no evidence that a ban on such acquisitions would result in the loss of any efficiencies in the use of the LMDS spectrum.

B. Cable Companies Should Be Ineligible To Bid For In-region LMDS Licenses.

The Commission has also requested comment on whether cable companies should be eligible to bid for LMDS licenses in geographic markets they presently serve. (NPRM, ¶ 125) The Department has examined this issue using the same analytic framework applied above to the question of LEC eligibility: (1) determining whether the asset would likely be used to compete in the market(s) served by the in-region cable company; (2) measurement of concentration in those markets prior to the acquisition; (3) analysis of likely effects of the acquisition on the state of competition in those markets; and (4) balancing of procompetitive efficiencies, if any, against the likely harm to competition from the transaction.

As the Commission stated in its Notice, the record in this proceeding contains ample evidence that the LMDS technology may be used to provide MVPD service.

(NPRM, ¶ 125) Each LMDS license must therefore be regarded as an important asset for a potential competitor in local MVPD markets.[10]

Furthermore, there can be little dispute that despite promising competitive developments in MVPD markets, local cable companies still retain substantial market power. Most local MVPD markets are monopolies controlled by the local cable franchises.[11] Overbuilds of cable firms are rare,[12] and thus far the level of concentration in these markets has been largely unaffected by new entrants using new technologies. Several studies have found evidence that prices in MVPD markets reflect the exercise of market power.[13] The Department concludes, therefore, that acquisition of the LMDS license by the in-region monopolist is likely to lead to anticompetitive effects in the MVPD market.

The likely anticompetitive effects of cable company acquisition of in-region

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[10] Like local telephone services, MVPD markets are essentially local in geographic scope. The alternative service providers that are available to consumers will vary from one locality to another, since cable franchises are awarded for a local region, and the opportunities for consumers to purchase MVPD products provided by suppliers from outside the local franchise area are extremely limited. The Commission contemplates awarding LMDS licenses for BTAs. As there may be considerable overlap between a cable franchisee's service area and a BTA, the Department concludes that in-region cable franchises and LMDS licenses are in the same geographic market.

[11] 1995 Competition Report, ¶¶ 5,9.

[12] 1995 Competition Report, ¶ 9

[13] See Robert N. Rubinovitz, "Market Power and Price Increases for Basic Cable Service Since Deregulation," RAND Journal of Economics, Spring 1993, and the references cited therein.

LMDS licenses should be balanced, however, against efficiencies that could be achieved only through such acquisitions. As discussed above in the context of LEC eligibility, such benefits conceivably might arise if the cable company was in a unique position to efficiently use the LMDS spectrum. Again, however, the record in this proceeding contains no specific evidence of such efficiencies. In the absence of efficiencies that are uniquely available to in-region cable companies, excluding such companies from LMDS spectrum ownership would not be likely to have any adverse impact on consumers or the efficient use of LMDS spectrum, since a large number of other potential bidders (including out-of-region cable companies) would remain. On the other hand, such an exclusion would prevent the anticompetitive effects that would likely result if an in-region cable company was permitted to acquire an asset that could be used to bring needed competition to the MVPD market.

C. Imposition of the Eligibility Restrictions Is Consistent With the 1996 Telecommunications Act and Prior Commission Precedent.

In its Notice, the Commission also requests comment on how its policies might best promote the competitive objectives of the Telecommunications Act of 1996 ("the Act"). (NPRM, ¶ 105) In response, some commenters have argued that the eligibility restrictions would be inconsistent with the Act in that the Act is meant to (1) promote LEC entry into video markets;[14] (2) facilitate the entry of new competitors into various telecommunications markets;[15] and (3) "provide for a pro competitive, deregulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunication and information technology and services to all Americans by opening all telecommunications markets to competition."[16] Moreover certain commenters have argued that since Congress did not specifically adopt LMDS cross-ownership restrictions, it would be "overreaching" for the Commission to do so now.[17]

The Department believes that the imposition of eligibility restrictions would be wholly consistent with the stated intentions of the Act and that the Commission should impose such restrictions where, as in this case, such restrictions can be expected to promote competition.

First, we note that the eligibility restrictions contemplated here would not prevent any firm, including in-region LECs and cable companies, from entering any market. In-region LECs would remain free to offer MVPD services, and in-region cable companies would remain free to offer local telephone services, using a variety of assets and technologies other than LMDS. Furthermore, the firms subject to the

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[14] See Comments of Bell Atlantic, p.7

[15] See Comments of US West, p.6

[16] See Comments of Ameritech, p.3

[17] See Comments of US West, p.7

proposed eligibility restrictions would be free to acquire out-of-region LMDS licenses. Since those firms have not argued in this proceeding that they would derive special efficiencies from the use of the technology in-region, they should have no special reason or justification for wanting in-region licenses.

More important, for the reasons explained above, the eligibility restrictions would serve to promote competitive entry, rather than allowing firms with market power to preempt such entry. Absent any indication that in-region LECs or cable companies are uniquely positioned to use LMDS spectrum to enter one another's markets, the restrictions will serve to enhance the prospects for more competition in either or both of those markets -- precisely the result intended by Congress.

Finally, precisely because Congress did not address the LMDS license issue and because the eligibility restrictions are consistent with Congress' stated general intent, it would in no way be overreaching for the Commission to impose the eligibility restrictions. No doubt many spectrum rights will be licensed by the Commission in the coming years. Congress could not possibly anticipate the competitive issues presented by each. This is clearly the Commission's role and while the Commission is justified and indeed wise to look to the recently enacted statute for guidance on Congress' general intent, it is farfetched to suggest that Congress' failure to specifically require a particular restriction deprives the Commission of authority to do so when warranted.

Commenters have argued that the eligibility restrictions contemplated by the

Commission would be inconsistent with prior Commission precedent on cross-ownership regulations for wireless licenses. The Department believes that while the Commission should apply a consistent framework in analyzing cross-ownership issues, the application of that framework need not yield the same result in every context. Each license issue involves a distinct technology and affects distinct markets: the Commission should be expected to take distinct positions based on the facts in each situation.[18]

D. Eligibility Restrictions Should Be Lifted When the Relevant Markets Become Competitive.

The Department's support for the proposed eligibility restrictions is predicated upon a lack of fully competitive local telephone service and MVPD markets. That analysis, however, suggests that such restrictions appropriately would be lifted if and when these markets are adequately competitive. We do not believe, however, that the "effective competition" test under section 623(l) of the Communications Act, or the "competitive checklist" in section 271 of the 1996 Act, represent appropriate measures of competition for triggering a sunset of these

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[18] For example, one commenter has argued that because the Commission permitted cable companies to bid for DBS licenses, the Commission should likewise permit cable companies to bid for in-region LMDS licenses. This analysis ignores crucial distinctions between DBS and LMDS: (1) the DBS license is national in scope, while LMDS licenses are local---to exclude a cable company from the DBS auction would therefore preclude that firm from entering many markets in which it has no market power; and (2) at least three firms were to be in a position to deploy DBS technology to enter MVPD markets, not just a single firm as is the case with LMDS.

restrictions. In light of the difficulty of establishing an objective and easily administrable standard for assessing the extent of competition in these markets, and the considerable uncertainty concerning the pace at which competition may emerge, the Commission should opt, instead, for a reexamination of these eligibility restrictions after a fixed period of time.

Respectfully submitted,

David Turetsky
Andrew Joskow
Deputy Assistant Attorneys General

Donald J. Russell, Chief
Telecommunications Task Force

Kate Balaban
Attorney
Telecommunications Task Force

Antitrust Division
U.S. Department of Justice
555 4th Street, N.W.
Room 8104
Washington, D.C. 20001
(202) 514-5621

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